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In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 74-1557

GEORGE J. HOGAN and MARIAN M. HOGAN,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

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GEORGE J. HOGAN and MARIAN M. HOGAN,
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UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

The Petitioners, George J. Hogan and Marian M. Hogan, respectfully pray that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Sixth Circuit entered in this proceeding on March 18, 1975.

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 51 F.2d ..... and appears in the Appendix hereto at page A7. The opinion of the District Court is reported at 367 F. Supp. 1022 and appears in the Appendix hereto at page A1.

JURISDICTION

The judgment of the Court of Appeals for the Sixth Circuit was entered on March 18, 1975. This Court's jurisdiction is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. Whether amounts automatically deducted and withheld from a federal Civil Service employee's salary and deposited in the Treasury of the United States to the credit of the Civil Service Retirement and Disability Fund, pursuant to 5 U.S.C. 8334, are taxable to the employee for federal income tax purposes in the year in which such amounts are deducted and withheld.

2. Whether the inclusion of such amounts in a federal Civil Service employee's gross taxable income for the year in which the same are deducted and withheld constitutes arbitrary, unreasonable, and unfair discrimination against federal Civil Service employees in violation of the equal protection and due process principles of the Fifth Amendment to the United States Constitution, since employees under substantially identical retirement plans in private business are not taxed on such amounts currently, but only at the time of actual or constructive receipt of same by the employee.

STATUTORY PROVISIONS INVOLVED[1]

United States Code, Title 5:

§8334. Deductions, contributions, and deposits

(a) The employing agency shall deduct and withhold 6-1/2 percent of the basic pay of an employee and 7-1/2 percent of the basic pay of a Member, and an equal amount shall be contributed from the appropriation or fund used to pay the employee or, in the case of an elected official, from an appropriation or fund available for payment of other salaries of the same office or establishment. When an employee in the legislative branch is paid by the Clerk of the House of Representatives, the Clerk may pay from the contingent fund of the House the contribution that otherwise would be contributed from the appropriation or fund used to pay the employee. The amounts so deducted and withheld, together with the amounts so contributed, shall be deposited in the Treasury of the United States to the credit of the Fund under such procedures as the Comptroller General of the United States may prescribe. Deposits made by an employee or Member under this section also shall be credited to the Fund.

(b) Each employee or Member is deemed to consent and agree to these deductions from basic pay. Notwithstanding any law or regulation affecting the pay of an employee or Member, payment less these deductions is a full and complete discharge and acquittance of all claims and demands for regular services during the period covered by the payment, except the right to the benefits to which the employee or Member is entitled under this subchapter.

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1. As in effect in the year 1968.

STATEMENT OF THE CASE

Petitioners, George J. Hogan and Marian M. Hogan, are husband and wife and citizens and residents of the State of Michigan. This action was instituted by Petitioners against the United States of America, Respondent, to recover from Respondent income taxes which Petitioners claim were illegally and erroneously assessed and collected from Petitioners for the calendar year 1968. Petitioners' cause of action arose under the Internal Revenue Laws of the United States, 26 U.S.C. 7422. The U. S. District Court for the Eastern District of Michigan, Southern Division, had jurisdiction of the cause under 28 U.S.C. 1346(a)(1) and venue under 28 U.S.C. 1402(a)(1).

Petitioners duly and timely filed Form 1040, Federal Income Tax Return, for the calendar year 1968 with the District Director of Internal Revenue, Detroit, Michigan, reporting total income for said year in the amount of $17,866.50, and the tax on said amount, after subtracting undisputed deductions and exemptions, was $2,665.53, which was duly and timely paid in full by Petitioners. Within the time allowed by law, Petitioners duly filed Form 1040X, Amended Federal Income Tax Return for the year 1968, claiming a refund of income taxes for said year in the amount of $255.62. The refund claimed was the amount of tax attributable to the sum of $961.02 of the $17,866.50 total income reported for 1968. The Petitioners' claim for refund was subsequently disallowed by the District Director of Internal Revenue.

During the calendar year 1968 and for many years prior thereto, Petitioner, George J. Hogan,[2] was an employee of

2. Petitioner Marian M. Hogan was a joint plaintiff in the action because as the wife of George J. Hogan she signed the joint income tax return for 1968.

the United States Government, being a classified Civil Service employee with the Internal Revenue Service. As such employee, he was subject to the Civil Service Retirement Act, 5 U.S.C. §§8331-8348. Under the provisions of said Act, as then in effect, the sum of $961.03, representing six and one-half percent (6-1/2%) of the basic pay earned by Petitioner George J. Hogan in 1968 by reason of his employment with the U. S. Government, was withheld from his paycheck pursuant to the provisions of Section 8334(a) of said Act and deposited with the Treasury of the United States to the credit of the Civil Service Retirement and Disability Fund (hereinafter "Fund"). Said amounts withheld from Petitioner's pay and deposited to the credit of the Fund were entered on his retirement record. Pursuant to Section 8334(b) of said Act, each employee is "deemed to consent and agree" to the above-described deductions from basic pay (hereinafter "Section 8334 deduction"). During 1968, approximately 2,650,000 federal employees had such Section 8334 deductions under said Act.

The amounts entered on an individual federal employee's retirement record constitute his "lump-sum credit" which includes the employee's Section 8334 deductions and sums deposited covering prior service, if any, and certain interest, all as described in Section 8331(8) of said Act. The federal employee has no access to his lump sum credit except upon conditions set forth in said Act, which in general are retirement, death, disability or termination of service.

Pursuant to Section 8333 of said Act, there are two general requirements which a classified employee must meet before he or his survivors are eligible for an annuity: 1) He must have completed at least five years of civilian service with the Government; and 2) He must have been subject to the provisions of said Act for at least one year

out of the last two years preceding separation from service unless separation is due to death or disability.

Pursuant to Section 8339 of said Act, the amount of the annuity payable upon retirement is directly related to the earnings and years of service of the individual employee. The formula is generally based on a percentage of the highest rate of service, the percentage increasing with the total number of years of service up to a maximum of eighty percent (80%).

Regardless of length of service, an employee who departs from Government service may withdraw his retirement fund lump-sum credit upon timely application therefor. Receipt of the lump-sum credit voids all annuity rights unless the employee is reemployed under the retirement system and a new retirement right is acquired. An employee with more than five years of service has, on departure, the option of leaving his lump-sum credit in the Fund and drawing regular deferred annuity benefits starting at age sixty-two.

The primary source of credits to the Fund are

1. Section 8334 deductions from the basic pay of employees;
2. Contributions by the employing Government agencies in amounts equal to their employees' Section 8334 deductions;
3. Appropriations to the Fund of amounts equivalent to a portion of the interest on the unfunded liability as computed at the interest rate used in the most recent valuation of the liability and of a portion of amounts equivalent to the cost for the year of allowing military service;

4. Appropriations to the Fund to finance the unfunded liability created by statutes which provide new or liberalized benefits or extend coverage of the Act to new groups of employees or provide increases in pay on which the benefits are computed;
5. Interest earned from the investment of monies not presently needed for payments from the Fund as well as gains on the sale of such investments.

The amounts to the credit of the Fund are invested in U. S. Government securities. Investment in the private market is not permitted by the Act.

The original Civil Service Retirement Act was enacted May 22, 1920. The Section 8334 deductions were first deducted from the federal employees' pay on August 1, 1920. As of June 30, 1969, the Fund balance was $20.6 billion and the unfunded liability was $57.7 billion as of June 1969. The annual input into the Fund from employees' Section 8334 deductions and equal contributions by Government agencies was 13% of payroll, whereas benefits and administrative expenses under the Act cost an amount equal to 13.86% of payroll. It was then estimated that by 1975 the cost of benefits and administrative expenses under the Act would exceed the income of the Fund from all sources, and by 1987 the Fund balance would be completely exhausted.

The Civil Service Retirement Act covers all appointees and elective officers and employees in or under the executive, judicial and legislative branches of the United States Government, and in the municipal government of the District of Columbia, except those excluded by law or regulation. All eligible employees are required to be covered by the Act, except members of Congress and certain employees in the legislative branch, who have the option of being covered by the Act.

Amounts standing to the credit of an employee in the Fund are not assignable, either in law or equity, are not subject to execution, levy, attachment, garnishment, or other legal processes, and are exempt from the claims of creditors, except that the Government may offset against any amounts payable to an employee under the Act, any indebtedness owing by such employee to the United States or any of its agencies.

The judgment of the District Court in favor of Respondent was affirmed by the Sixth Circuit Court of Appeals. The Court of Appeals' opinion is based principally on its finding that the Section 8334 deductions are the employees' own contributions to the Retirement Fund and not contributions of the employer.

REASONS FOR GRANTING THE WRIT

1. The Decision Below Conflicts with the Decision of This Court in the Case of Pennie v. Reis, 132 U.S. 464 (1889).

The Sixth Circuit held that the Section 8334 deductions from a federal employee's pay are includable in his taxable income because they are employee contributions and not employer contributions for income tax purposes. This holding is inconsistent with the decision of this Court in the case of *Pennie* v. *Reis*, 132 U.S. 464 (1889) which involved a California statute requiring that $2.00 per month be deducted from a policeman's salary and deposited in a "Police Life and Health Insurance Fund." The Supreme Court unanimously held that such deductions were not contributions by the employee but were in reality state appropriations, Mr. Justice Field stating:

> "[N]o money was contributed by the police officer out of his salary. . . . [T]he money which went into that fund . . . was money . . . the State retained in its possession for the creation of this very fund, the balance . . . being the only compensation paid to the police officer. Though called part of the officer's compensation, he never received it or controlled it, nor could he prevent its appropriation to the fund in question. . . . Being a fund raised in that way, it was entirely at the disposal of the government. . . . If the two dollars a month, retained out of the alleged compensation of the police officer, had been in fact paid to him, and thus become subject to his absolute control, and after such payment he had been induced to contribute it . . . a different question would have been raised. . . . It is sufficient that the two dollars retained from the police officer each month, though called in the law a part of his compensation, were, in fact, an appropriation of that amount by the State. . . ." 132 U.S. 464, 470-1.

A Civil Service employee's compensation is reduced as a condition of his employment by the automatic deductions in order to help defray the Government's cost of the retirement and other benefits provided under the System. In effect, the Act provides that the Government will pay these employees 6.5% less than their stated rate of compensation and will use the automatic deductions, together with other Government contributions, to help defray the cost of the benefits provided under the Act.

In point of fact, as *Pennie* says, the statutorily mandated deductions are not current income to the employee. Applying *Pennie's* analysis to the federal employee's situation, the Civil Service Retirement Act, in legal effect, provides that the federal employee shall receive 93.5x$ each

month as current taxable income, and in addition thereto, the Government will credit $6.5x each month for the employee to the Retirement Fund from which the employee shall receive benefits in the future in the event of his retirement, disability, death or resignation. Under *Pennie*, such amounts mandatorily withheld at the source and paid over to the Fund by the employer, are clearly not to be considered current taxable income to the employee.

2. In Failing to Apply the Constructive Receipt Doctrine to Determine the Taxability of the Statutorily Mandated Deductions from the Federal Employee's Pay for the Retirement Plan, the Decision Below Conflicts in Principle with the Decision of the Fourth Circuit in Hicks v. United States, 314 F.2d 180 (C.A. 4, 1963).

The Court below refused to apply the doctrine of constructive receipt in its consideration of the taxability of the mandatory deductions for retirement purposes. A federal employee cannot elect to receive the Section 8334 deductions in cash; he must agree, as a condition of his employment, to such deductions. He is thus in neither actual nor constructive receipt of the deducted amounts.

The Fourth Circuit Court of Appeals, in *Hicks* v. *U. S.*, 314 F.2d 180 (C.A. 4, 1963), applied the constructive receipt doctrine to determine the taxability of amounts paid into a retirement fund for the employee's benefit. In that case, the taxpayer was the employee of a bank which had a profit-sharing plan with provisions as follows: a) The bank set aside 6% of its net profits each year; b) 40% of said amount was paid into a trust to the credit of the employees in proportion to their salaries, to be held for their retirement benefit; c) 60% of said amount was distributed proportionately among the employees in cash unless an

employee directed the bank, in writing, at least 31 days before the end of the year, to pay his share directly into the trust to his account. In the year in question the taxpayer had directed payment of his share of the 60% of the benefit amount to the trust and did not include said amount as taxable income. The Court stated that there was no question that the taxpayer's share of the 40% contribution was not taxable to him during that year since he had no control over that amount which would not become available to him until later when specific conditions were met. The Court held that the taxpayer's share of the 60% was taxable to him that year since he had the option to take it in cash that year or direct its payment into the trust. The Court emphasized that the taxability of the latter amount was determined by the fact that the taxpayer had a choice whether to take it in cash that year or have it deposited in the trust. The Court said:

"Taxpayer Hicks, however, contends that the requirement that he direct the Bank to pay his proportionate share of the 60% to the trustee by December first, more than thirty-one days before the amount or existence of his share became known, was a 'substantial limitation or restriction' under Regulation 1.451-2(a), supra, which would defeat the theory of constructive receipt of taxable income by him in 1958. The District Court correctly concluded that nothing prevented Hicks from receiving payment of his portion of the full 60% in cash on the date of distribution by the Bank. Hicks' written instruction diverting the payment from himself to the trustee was a voluntary act in exercise of his power to dispose of the income represented by that payment. Upon deposit of the payment in the trust, Hicks fully realized the economic gain and obtained benefits similar to those available to him had he elected to take the cash and purchase an

annuity. The requirement that election to deposit the payment in the trust be made more than thirty days in advance established the procedure for obtaining increased participation in the trust but it did not, by imposing either penalty or delay, prevent Hicks from taking the full amount in cash. Therefore, the payment here involved became available without condition or limitation in 1958, Hicks constructively received it at that time and it was properly subject to the payment of income tax for that year." 314 F.2d 180, 185.

The amounts paid into the Civil Service Retirement Fund for the federal employee's benefit are precisely comparable to the bank employee's share of the 40% portion of the retirement plan in the *Hicks* case. Both amounts represent current compensation to the employee for present services rendered. The amount of the employee's entitlement is measured by his regular basic compensation. The employee has no election or choice with respect to the receipt of said amount; under the terms of the plan, the employee's receipt is automatically deferred.

The Sixth Circuit below relied upon three cases in which the Courts had upheld the taxability of the Civil Service employee's Section 8334 deductions, namely, *Miller* v. *Commissioner,* 144 F.2d 287 (C.A. 4, 1944); *Megibow* v. *Commissioner,* 218 F.2d 687 (C.A. 4, 1955); *Lawrence J. Cohen,* 63 T.C. No. 23 (1974). We submit that the *Megibow* case has no independent significance as precedent, as the Third Circuit in that case found for the Government solely on the authority of the *Miller case.* We also submit that the Fourth Circuit's holding in the *Miller* case was implicitly overruled by its decision and opinion in *Hicks, supra,* decided in 1963. The *Cohen* case is now on appeal to the Ninth Circuit and will be scheduled for argument later this year.

3. The Decision Below Involves an Issue Affecting All Participants in the Federal Civil Service and Also Millions of Employees of States, Municipalities, School Districts, and Other Public Entities Having Similarly Structured Retirement Programs.

In this case, the Petitioner is challenging the Respondent's discriminatory income tax treatment of the amounts paid into the Civil Service Retirement Fund to provide the retirement benefits to the federal employees. The Petitioner and all other federal employees subject to the Retirement Act are now paying income taxes on money which they do not currently receive, and while they or their estates will draw down this money some day, their current tax obligations should be no greater than those of private employees under substantially identical retirement programs, who are permitted to defer tax on the amounts provided for retirement.

The development and refinement of the concept of deferred compensation have come a long way since the *Miller* case, *supra,* was rendered in 1944. The tax policy of the United States Government has been consistent with its public and social policy to encourage retirement programs and to allow certain tax advantages to taxpayers who set aside a portion of their current income to finance the years when they are no longer productive.

The *Miller* case was the first decision at the Circuit level involving the issue herein. It decided in favor of the taxability of the amounts withheld from the federal employee's pay, but the rationale for that decision is now obsolete. The test in *Miller* was: It is compensation earned now for current services which the Government will pay to the employee at some time in the future; therefore, it is currently taxable. Of course, this is not the test under

existing law today as it is being applied to approved retirement plans and other deferred compensation programs in the private sector. The Fourth Circuit in the *Miller* case and the Sixth Circuit below completely ignored the decision of this Court in the *Pennie* case, *supra*.

The issue in this case is of major significance and importance. It affects all participants in the federal Civil Service which number approximately 2,650,000. It also affects the millions of employees of state and local governmental entities which have retirement programs funded by compulsory withholdings from employees' pay. It is to be expected that litigation will continue to arise to test the propriety of the income tax consequences to public employees who are required by law to suffer deductions from their current pay in order to fund a plan which will pay them retirement benefits at some future time.

The decision of the Sixth Circuit in this case is clearly erroneous in the light of this Court's holding in the *Pennie* case that such mandatory withholdings from a public employee's pay are not current income to the employee regardless of the language of the statute defining such withholdings. To permit the decision below to stand will be to perpetuate arbitrary and discriminatory tax treatment of all federal Civil Service employees and millions of similarly situated employees of other public entities. The time has come for this Supreme Court to reaffirm its holding in the *Pennie* case and to issue definitive guidelines on the taxability of statutorily mandated deductions from the pay of federal employees and other public employees.

CONCLUSION

For the reasons stated, a Writ of Certiorari should issue to review the judgment and opinion of the Sixth Circuit.

Respectfully submitted,

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APPENDIX

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF MICHIGAN
SOUTHERN DIVISION

CIVIL NO. 38535

GEORGE J. HOGAN and MARIAN M. HOGAN,
Plaintiffs,

vs.

UNITED STATES OF AMERICA,
Defendant.

MEMORANDUM

Plaintiffs herein are husband and wife who bring this action to recover income taxes allegedly illegally and erroneously assessed and collected from them for the calendar year 1968. Plaintiff husband is an employee of the United States Government, a classified Civil Service employee with the Internal Revenue Service. He was so employed during the calendar year 1968 and for many years prior thereto. Plaintiffs filed Federal Income Tax Return Form 1040 for the calendar year 1968, in which they reported income for that year in the amount of $17,886.50 on which they paid a tax of $2,665.53, having subtracted allowable deductions and exemptions from said income. Plaintiffs (hereinafter referred to as plaintiff) filed a claim for refund for $255.62 based on their theory that they erroneously included in their gross income the sum of $961.03. This sum represents the amount of tax attributable to the sum of $961.03 of the $17,866.50 reported income for the 1968 calendar year as plaintiff's mandatory contribution to the retirement program under the Civil Service Retirement Act, 5 U.S.C.A. §8331, et seq. The District Director

of Internal Revenue disallowed the claim, having determined that the $961.03 was includible in plaintiff's gross income for the 1968 calendar year. It is the position of plaintiff, as set forth in the Complaint, that such determination constitutes "a taking of plaintiffs' property without due process of law in violation of plaintiffs' rights under the 5th Amendment to the Constitution of the United States." Plaintiff equates his situation to that of an employee in private business who is not required to "report as current income that income earned under a deferred compensation plan, if the plan is unfunded and if the election to defer payment of income is made prior to the time of performance of the services for which it is to be payable." He says that "such income is taxable only at the time of actual or constructive receipt by the employee." This case has been submitted on Stipulation of Facts, briefs of counsel and oral argument. The parties are in agreement that the legal issue here presented is whether that portion of the Federal employee's compensation automatically withheld (or deducted) from his pay is includible in his income for purposes of the Federal Income Tax in the year such portion is withheld and paid into the Civil Service Retirement Fund. The Government contends that the total compensation figure prior to the withholding/deduction is includible in plaintiff's current income. Plaintiff contends that the withheld/deducted portion is not income to him until he receives it actually or constructively. It should be here noted that plaintiff is not attacking the withholding/deduction, but the tax treatment of it. Pursuant to 5 U.S.C.A. §8334(b) each employee "is deemed to consent and agree to these deductions from basic pay." Such deductions are paid into the Civil Service Retirement Fund and an equal amount "shall be contributed from the appropriation or fund used to pay the employee." 5 U.S.C.A. §8334(a). Such matching contribution is not included in the employee's gross income for income tax purposes.

Both parties herein cite the cases of *Miller* v. *Commissioner of Internal Revenue*, 144 F.2d 287 (CA 4, 1944), and *Megibow* v. *Commissioner of Internal Revenue*, 218 F.2d 687 (CA 3, 1955). The Government relies on the holdings in these two cases as supportive of its position that plaintiff is not entitled to the refund he seeks. Plaintiff contends that the holdings are no longer controlling because of recent Internal Revenue Service rulings with respect to private contractual arrangements between employers and employees. Both parties argue in favor of their respective positions regardless of whether the retirement plan is a qualified or a non-qualified plan. Plaintiff contends that said plan is a non-qualified deferred compensation plan because the system does not satisfy the funding requirements of the Internal Revenue Code for a qualified plan. Plaintiff contends that under the precedents applicable to non-qualified deferred compensation plans automatic deductions are not currently taxable. The Government's position in this respect is that there is no deferred compensation situation here present, that plaintiff's total salary is present compensation, a portion of which he pays into the Civil Service Retirement Fund by deduction from such compensation. Plaintiff takes the position that even if the plan be considered to be a qualified one the automatic deductions are in effect employer rather than employee contributions. He likens such contributions to bonuses paid by an employer into a qualified plan, or to an employee election to have his salary reduced by the payment of the reduction to the qualified plan or by election of the reduction to a "section 403(b) annuity contract" in all of which situations the payments are considered to be employer contributions. The Government distinguishes all of these situations from that of plaintiff and relies on the determinations in the *Miller* and *Megibow* cases, *supra*, as well as that in *United States* v. *Bayse*, 410 U.S. 441 (1973).

In *Miller* v. *Commissioner of Internal Revenue*, 144 F.2d 287, 289 (CA 4, 1944) the Court stated as follows:

> But even if it should be considered that the employee did not receive the full amount of $2700 and paid $94.56 therefrom to purchase an annuity and secure the other protection afforded by the Act, he, under any view of the transaction, as a result thereof, received additional compensation in the form of economic benefits under the Retirement Act. These benefits take the place of the part of the taxpayer's salary which was withheld, and, in any event, had an equal or greater value than the sum withheld and constitute income just as if the taxpayer had received his entire salary in cash. As aptly said by the Tax Court in its Opinion, "These aspects of the retirement plan seem to us to demonstrate that there have been purchased by the employee substantial rights, of a value which can in no event fall materially below the amount of his own contribution, which presently belong to him, and which are unequivocally provided for his ultimate benefit under whatever contingency and in whatever circumstance the occasion for that benefit should arise. They are in that respect comparable to, and for our purposes indistinguishable from, an annuity contract, of which the employer constitutes itself the issuer, setting aside reserves for that purpose and making investments thereof comparable to those which would be employed by companies engaged in that business." The decisions in cases where an employer has paid premiums on life insurance policies issued for the benefit of an employee are in point. In such cases it is held that the amount paid as premiums is presumed to be additional compensation for the employee's services, and that it constitutes income to the employee on the theory that he has received a benefit in the form of insurance protection as a substitute for the cash payment.

In treating the same issue the Court in *Megibow* v. *Commissioner of Internal Revenue*, 218 F.2d 687 (CA 3, 1955) said the following at pages 691-692:

> The $375.28 was a part of the taxpayer's fixed salary for 1949, but this amount was deducted because when the taxpayer was employed by the Internal Revenue Service he was deemed by law to have consented and agreed to the withholding of it as his contribution to the Civil Service Fund. Since the taxpayer consented to the deductions, they cannot be considered the employer's contributions. The identical question was well considered in Miller v. Commissioner of Internal Revenue, 4 Cir., 1944, 144 F.2d 287, where such contributions were found to be taxable to the employee.
>
> The taxpayers refer us to the case of MacLeod v. Fernandez, 1 Cir., 1938, 101 F.2d 20, certiorari denied, sub nom. Toste v. Macleod, 1939, 308 U.S. 561, 60 S.Ct. 72, 84 L.Ed. 471, to support their contention that they had no vested rights in the Civil Service Fund as a result of the deductions and therefore the money contributed to the fund was not their contribution. It does not follow that because an employee has no vested rights in the fund he could not have made contributions to the fund, but we meet the taxpayers' contention as a similar contention was met in the Miller case in which the court said:
>
> > "There is no merit in the contention of the petitioners that * * * the employee had no vested rights under the Civil Service Retirement Act [5 U.S.C.A. §691 et seq.] * * * [H]e had the right to receive an annuity upon retirement, and to receive a return of the amount withheld from his salary, with interest, upon separation from the service, or death. These rights were secured in consideration of contributions made from his salary, and at least to the ex-

tent of such contributions made, they could not be taken from him under the provisions of the Act, and we may not assume that Congress, if it could, would change the law so as to deprive him of the substantial rights acquired thereunder." 144 F.2d at page 290.

We conclude that the $375.28 was part of the taxpayer's salary in 1949 and was properly included in his gross income.

In *United States* v. *Bayse*, 410 U.S. 441, 447 (1973) the Supreme Court referred to "two familiar principles of income taxation, first, that income is taxed to the party who earns it and that liability may not be avoided through an anticipatory assignment of that income * * *."

In light of the existing statutory provisions providing for *employee* contributions to the Civil Service Retirement Fund and for matching government contributions, and in reliance on the cases hereinbefore cited, the Court concludes that the deductions from plaintiff's paycheck which are paid into said Fund are includible in his compensation for Federal Income Tax purposes for the year they are deducted. If such deductions are to be treated or considered as employer contributions it is for the Congress, not the courts, to so legislate. The claim of due process denial is without merit.

A copy of the Stipulation of Facts entered into by the parties is attached hereto. The Exhibits underlying said Stipulation are part of the court file in this matter and are therefore available for inspection.

An order may be presented in accordance with this memorandum.

/s/ Thomas P. Thornton
Thomas P. Thornton
United States District Judge

Dated: November 28, 1973.

No. 74-1379

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GEORGE J. HOGAN and MARIAN M. HOGAN,
Plaintiff-Appellants,

v.

UNITED STATES OF AMERICA,
Defendant-Appellee.

Appeal from the United States District Court for the Eastern District of Michigan, Southern Division.

Decided and Filed March 18, 1975.

Before: EDWARDS, CELEBREZZE and LIVELY, Circuit Judges.

EDWARDS, Circuit Judge. This is an appeal from dismissal of a suit for refund of federal taxes paid for the tax year 1968 by a federal Civil Service employee.[1] He seeks return of taxes he was required to pay upon the percentage of his salary (6.5%) which was deducted in the year in question and credited in his name to the Civil Service Retirement and Disability Fund, 5 U.S.C. § 8334(a) and § 8348 (1970).

The statute provides that the federal employee "is deemed to consent and agree to these deductions from basic pay." 5 U.S.C. § 8334(b) (1970). It also provides for an equal amount to be contributed by the government to the Civil Service Retirement Fund "from the appropriation or a fund used to pay the employee." 5 U.S.C. § 8334(a)

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1. Marian M. Hogan is a joint plaintiff only because as the taxpayer's wife she signed the joint tax return.

(1970). These matching funds are not, however, included in the employee's gross income for purposes of income tax.

This case was heard in the District Court on a stipulation of facts which is a part of our appellate record which we incorporate by reference, quoting herein only directly pertinent paragraphs as follows:

> 9. Under Section 8334(a) of the Civil Service Retirement Act[2] as it was in force during the year in suit, 6-1/2 percent of the basic pay of an employee covered by the Act was required to be withheld from his payroll check and deposited with the Treasury of the United States to the credit of the "Civil Service Retirement and Disability Fund" (hereinafter Fund); and an equal amount was deposited in the Treasury of the United States to the credit of the Fund by the Government agency which employed him. Said amounts withheld from the employee's basic pay and deposited to the credit of the Fund were entered on the individual employee's retirement record pursuant to Section 8334(f) of the Civil Service Retirement Act. Said amounts deposited by the Government agency employing the individual employees were not credited to any individual employee's retirement record. Pursuant to Section 8334(b) of the Civil Service Retirement Act, each employee is deemed to consent and agree to the above-described deductions from basic pay. Said deductions shall hereafter be referred to in this stipulation as the employee's "Section 8334 deduction." During 1968 approximately 2,650,000 persons had such Section 8334 deductions under the Act.

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2. The Civil Service Retirement Act was originally passed in 1920. Act of May 22, 1920, Pub. L. No. 66-215, 41 Stat. 618. The Act is codified as subchapter III of chapter 83 of Title 5 of the United States Code. 5 U.S.C. §§ 8331-8348 (1970). Thus the references to the Act in this stipulation incorporate the section denomination used in the Code.

10. For executive branch employees, the percentage rates of such Section 8334 deductions under the Civil Service Retirement Act from its inception and with its various amendments are as follows:

Date of Service	Percentage Rates for Deductions from Basic Pay
Before August, 1920	0
From August, 1920, to June, 1926	2-1/2
From July, 1926, to June, 1942	3-1/2
From July, 1942, to June, 1948	5
From July, 1948, to September, 1956	6
From October, 1956, to December, 1969	6-1/2
From January, 1970, to Present	7

11. The unrefunded amounts entered on an individual employee's retirement record constitute his "lump-sum credit" which includes the employee's Section 8334 deductions as well as sums deposited covering prior service and certain interest, all as described in Section 8331(8) of the Civil Service Retirement Act. The employee has no access to his lump-sum credit except upon conditions set forth in the Civil Service Retirement Act which in general are retirement, death, disability or termination of service.

12. Pursuant to Section 8333 of the Civil Service Retirement Act there are two general requirements

which a classified employee must meet before he or his survivors are eligible for an annuity:

1. He must have completed at least five years of civilian service with the Government;
2. He must have been subject to the provisions of the Civil Service Retirement Act for at least one year out of the last two years preceding separating from service unless separation is due to death or disability.

13. Pursuant to Section 8339 of the Civil Service Retirement Act the amount of the annuity payable upon retirement is directly related to the earnings and years of service of the individual employee. The formula is generally based on a percentage of the highest rate of service, the percentage increasing with the total number of years of service up to a maximum of eighty percent.

14. Most employees covered by the Civil Service Retirement Act are required to retire when they become 70 years of age if they have completed 15 years of service. An employee covered by the Act is entitled to an annuity after becoming 55 years of age and completing at least 30 years of service; after becoming 60 years of age and completing at least 20 years of service; and after becoming 62 years of age and completing five years of service. Total disability payments are payable after five years of service.

15. The Civil Service Retirement Act provides for additional benefits such as survivor-annuity benefits to widows or widowers and dependent children of deceased employees. If all annuity rights under the Civil Service Retirement Act which are based on the service of a deceased employee or members terminate

before the total annuity paid equals the lump-sum credit, the difference is paid to the survivors or next of kin of the employee or member.

16. Regardless of length of service, an employee who departs from Government service for any reason, may withdraw his retirement fund lump-sum credit if his departure occurs and his refund claim is filed with the Civil Service Commission at least thirty-one (31) days before the commencing date of any annuity for which he may be eligible. Receipt of the lump-sum credit voids all annuity rights unless reemployed under the retirement system and a new retirement right is acquired. An employee with more than five years of service has, on departure, the option of leaving his lump-sum credit in the retirement fund and drawing regular deferred annuity benefits starting at age sixty-two.

* * *

21. The original Civil Service Retirement Act was enacted on May 22, 1920. The Section 8334 deductions were first deducted from the Federal Employees' pay on August 1, 1920. As of June 30, 1969, the Fund balance in the Civil Service Retirement Fund was $20.6 billion. On that date the unfunded liability was $57.7 billion.

* * *

23. As of June 1969, the annual input into the Fund from employees' Section 8334 deductions and equal contributions by Government agencies was 13 percent of payroll, whereas benefits and administrative expenses under the Act cost an amount equal to 13.86 percent of payroll. It was estimated that at the rate by 1975 the cost of benefits and administrative

expenses under the Act would exceed the income of the Fund from all sources and by 1987 the Fund balance would be completely exhausted.

* * *

27. In 1969 the Administration and Congress recognized that the situation described in paragraph 23 existed. Legislation was proposed to stabilize and control the unfunded liability. In 1969 Public Law 91-93[3] was enacted which contained financing provision in a "three-step" method as follows:

> (1) The employees' Section 8334 deductions and the Government agencies' employer contributions were raised to 7 percent each, for a total of 14 percent of payroll, to cover the costs of current benefits and administrative costs which were 13.86 percent of payroll at that time;
>
> (2) All future legislation creating retirement liability by benefit or pay increases or extension of coverage would be deemed to authorize appropriations to the Fund to finance the unfunded liability attributable thereto on a thirty-year amortization schedule;
>
> (3) Permanent indefinite appropriations were provided in gradually increasing amounts over ten years so that they would equal, in 1980, 100 percent of the amount equivalent to what would be the interest on the unfunded liability each year, computed at the interest rate used in computing the unfunded liability; as well as the estimated costs of annuities for that year attributable to credit allowed for military service.

3. Act of Oct. 20, 1969, Pub. L. No. 91-93, 83 Stat. 137, *amending* 5 U.S.C. § 8348 (1966).

> Under these financing provisions, it is estimated that the unfunded liability will level off at approximately $76 billion in 1980 with the exception of additional liability attributable to the cost-of-living increases pursuant to Section 8340 of the Act.

Appellant taxpayer contended below, and contends here, that the 1968 retirement deductions should be treated as an employer contribution and, hence, under recent income tax rulings, not taxable to him until received. He argues that the funds deducted are not includable in gross income since the Civil Service Employees Retirement Fund is neither a "qualified" plan nor "an independent trust" within the meaning of Sections 401 and 402 of the Internal Revenue Code of 1954. Finally, (without distinguishing between equal protection and due process) he contends the tax as assessed against and paid by him is discriminatory as compared to the treatment accorded privately employed or self-employed taxpayers and violates his right to due process of law.

Appellant, as we read his argument, emphasizes four facts: 1) that the 1968 deductions for the retirement fund were mandatory, 2) that the Civil Service Retirement Fund is not funded so as to be able presently to pay off its accrued liability, 3) that the fund is not independent of his employer and, hence, not an independent trust, and 4) that an increasing number of privately employed or self-employed persons are allowed to make payments (or have payments made) to pension funds which payments are not includable in their gross income for tax purposes.

The questions posed are not new ones and they have been answered repeatedly by denial of the taxpayers' claims. *Miller* v. *Commissioner*, 144 F.2d 287 (4th Cir. 1944); *Megibow* v. *Commissioner*, 218 F.2d 687 (3d Cir. 1955); *Lawrence J. Cohen*, 63 T.C. No. 23 (Nov. 26, 1974).

See also Eugene G. Feistman, 63 T.C. No. 13 (Nov. 12, 1974).

In our instant appeal the District Judge relied strongly upon the *Miller* and *Megibow* cases in holding that the Civil Service Retirement Fund deductions from appellant's pay check were part of his gross income for purposes of income taxation.

We have reviewed this record and the old and the new cases cited above, and the more recent legislation and regulations which are cited to us by appellant in his discrimination argument. We believe that the *Miller*, *Megibow* and *Cohen* cases just cited clearly represent accurate interpretation of the intention of Congress in relation to the legislation in question.

1) Appellant's salary is and was fixed by statute. It included the sum which was deducted in 1968 for purposes of the Civil Service Retirement Plan. The deduction was made because he was eligible for retirement benefits. If he had not been eligible for the retirement plan, his compensation clearly would have been the full amount. In the *Cohen* case the Tax Court said:

> As is clear from the . . . *Megibow* case, we considered the same argument with respect to the amount withheld from the taxpayer's salary being a contribution to a qualified pension plan by the employer that petitioner has made in the instant case. As respondent points out, the salaries of Federal employees in the various grades provided by Civil Service are set by statute, and as the stipulated facts show this statutory salary is the starting point in computing the amount of the paycheck to be issued to each employee. If for some reason such as being a temporary employee or a non-electing Member of Congress, a person is not

> covered by the Retirement Act but does have a salary fixed by statute, his gross pay is computed on the basis of the statutory salary for his classification or grade even though there is no section 8334 deduction made for an amount withheld under the Retirement Act. In our view petitioners have shown no basis for their position that the amount withheld under the Civil Service Retirement Act from an employee's basic pay is not a part of the employee's compensation. We therefore conclude that there is no basis for changing the holding we made in *Isaiah Megibow*, *supra*, that the withheld amount is an employee's payment into the Civil Service Retirement Fund and not an employer's payment. *Lawrence J. Cohen*, *supra* at 25-26 of the slip opinion. (Footnote omitted.)

We agree with the Tax Court (and with the District Court below) that the disputed 1968 deductions were employee contributions and not employer contributions for income tax purposes.

2) Appellant's 1968 contributions did represent valuable rights which were vested in him at the time. For example, they, plus the equal or greater sums pledged by the government served to purchase specified retirement benefits available to him on retirement as well as disability benefits in the event of disabling accident or illness. 5 U.S.C. §§ 8336-8338 (1970). They were also returnable to him, usually with interest, in the event of his leaving the service before eligibility for retirement. 5 U.S.C. §§ 8331 (8) and 8342 (1970). They were also payable, usually with interest, to his heirs if at death the lump sum credit had not previously been paid to him in benefits. 5 U.S.C. § 8342(d)—(f) (1970). And these rights, if for any reason they were denied him, appellant could enforce through suit against the United States under the Tucker Act, *as*

amended, 28 U.S.C. § 1346 (1970); *Dismuke* v. *United States*, 297 U.S. 167, 170 (1936).

Present vesting of a right, even if its enjoyment is postponed to the happening of a future event, is an important aspect of gross income for income tax purposes. *Renton K. Brodie*, 1 T.C. 275 (1942). *See also United States* v. *Basye*, 410 U.S. 441, 452 (1973).

3) Congress has intentionally required the employee contribution which is disputed here with the full knowledge that income tax liability resulted. In the legislative history of the Employee Retirement Income Security Act of 1974,[4] we find this pertinent discussion:

> *Designated contributions.*—Under present law, contributions which are designated as employee conbutions are generally treated as employee contributions for purposes of the Federal tax law. For example, this is the case with respect to employee contributions under the Federal Civil Service plan. Your committee's bill contains a provision[5] to clarify this rule for the future. This provision provides that amounts that are contributed to a qualified plan are not to be treated as an employer contribution if they are designated as employee contributions.
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> This provision gives effect to the source of the contributions, as designated in the plan. For example, if the appropriate committees of the Congress were to report legislation regarding employee contributions under the Federal Civil Service plan so that the present employee's contributions would become employer contributions under the Federal Civil Service

4. Act of Sept. 2, 1974, Pub. L. No. 93-406, ... Stat. .....

5. *See* § 1015 of 1974 Act, *supra*.

> plan (and that legislation were to be enacted), then those contributions would constitute employer contributions to the plan, which would be excludable from the employee's income when made. The same rule would apply to State and local governmental plans which now designate contributions as employee contributions, if the appropriate governmental bodies change the provisions of their plans. H.R. Rep. No. 93-807, 93rd Cong., 2nd Sess., reported in 8A U.S. Code Cong. & Adm. News, 288, 428 (1974).

4) Since we have held that the disputed amounts of gross income are includable for income tax purposes because they are employee contributions rather than employer contributions, we do not need to determine whether or not the Civil Service Employee Retirement Plan is a "qualified" plan under Section 401 or an Independent Trust under Section 402 of the Internal Revenue Code of 1954.

If there were need for findings on either issue, however, we observe that Congress has specifically designated the Civil Service Employees Retirement Fund as an Independent Trust.

In 31 U.S.C. § 725s (1970), Congress declared:

> **725s. Trust funds.**—(a) The funds appearing on the books of the Government and listed in subsections (b) and (c) of this section shall be classified on the books of the Treasury as trust funds. All moneys accruing to these funds are hereby appropriated, and shall be disbursed in compliance with the terms of the trust. . . .
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> (6) Civil Service Retirement and Disability Fund (0t843).

5) We do not believe this record presents any significant constitutional issue arising out of discriminatory treatment of federal civil service employees as compared to private employees or the privately self-employed. There are many distinctions between pension plans for employees in the private sector and this pension plan for government employees to warrant separate classification of the latter to be found to be reasonable. One of the primary distinctions, of course, is the relative insecurity of many private pension plans compared to the statutory commitment of the United States Government to the payment of the Civil Service Retirement Plan benefits. *See, e.g.*, H.R. Rep. No. 93-807, *supra* at 297.

We have also considered the fact that the statutory language we quoted at the outset of this opinion appears in form to create an irrebuttable presumption that each employee has consented to the deductions—a presumption which (at least in the case of an employee who intended to stay on the government job for less than five years) might well not be true. Despite the form of language employed, however, we believe that Congress' intention was to make employee participation in the Civil Service Retirement Plan a mandatory condition of employment. Such a condition is by no means uncommon in private pension schemes, *see e.g.*, Rev. Rul. 70-658, 1970-2 CUM. BULL. 87, and does not serve to deprive government employees of any constitutional right.

We conclude that Congress has determined that the federal employee contribution to the Civil Service Pension Fund is presently includable in gross income, that Congress has so specified and has the right to do so, and that any relief must be by Congressional enactment.

The judgment of the District Court is affirmed.